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IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST
AND SAVINGS ASSOCIATION,
Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,
Respondent.

**On Writ of Certiorari to the
United States Court of Appeals
for the Seventh Circuit**

BRIEF *AMICUS CURIAE* OF THE AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF PETITIONER

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31pp

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF *AMICUS CURIAE*	2
SUMMARY OF ARGUMENT	2
ARGUMENT	4
I. THE PLAIN LANGUAGE OF SECTION 1129(b)(2) OF THE BANKRUPTCY CODE PROHIBITS THE GRANT TO OLD EQUITY, OVER THE OBJECTION OF A CLASS OF CREDITORS, OF AN EXCLUSIVE RIGHT TO PURCHASE OWNERSHIP OF THE REORGANIZED DEBTOR	4
II. THE LAW AND PRACTICE PREVAILING BEFORE THE ENACTMENT OF THE BANKRUPTCY CODE IN 1978 DO NOT SUPPORT THE DECISION OF THE COURT OF APPEALS	9
A. Pre-Code Law and Practice Are Irrelevant When the Language of the Bankruptcy Code Is Clear	10
B. The New Value Doctrine Was Not an Established Element of Pre-Code Law or Practice	12
C. Congress Indicated Clearly That It Intended to Eliminate the New Value Doctrine When It Modified and Codified the Absolute Priority Rule, Without Exception, as Part of a Complete Overhaul of the Reorganization Provisions of the Bankruptcy Act	14
III. AN EQUITY-ONLY NEW VALUE RIGHT IS INCONSISTENT WITH THE POLICIES UNDERLYING THE BANKRUPTCY CODE	21
CONLUSION	25

TABLE OF AUTHORITIES

Cases — Page

In re Abbotts Dairies of Pennsylvania, Inc., 788 F.2d 143 (3d Cir. 1986) 22
Barnhill v. Johnson, 503 U.S. 393 (1992) 8
In re Bonner Mall Partnership, 2 F.3d 899 (9th Cir. 1993), *motion to vacate denied and case dismissed*, 513 U.S. 18 (1994) 3, 7
In re Bryson Properties, XVIII, 961 F.2d 496 (4th Cir.), *cert. denied*, 506 U.S. 866 (1992) 5
Caminetti v. United States, 242 U.S. 470 (1917) 8
Case v. Los Angeles Lumber Products Co., 308 U.S. 106 (1939) ..... *passim*
Central Trust Co. v. Official Creditors' Committee, 454 U.S. 354 (1982) 9
In re Coltex Loop Central Three Partners, L.P., 138 F.3d 39 (2d Cir. 1998) 5
Consolidated Rock Products Co. v. Du Bois, 312 U.S. 510 (1941) 12
Dewsnup v. Timm, 502 U.S. 410 (1992) 9, 10, 13
In re Food Barn Stores, Inc., 107 F.3d 558 (8th Cir. 1997) 22
Kansas City Terminal Railway Co. v. Central Union Trust Co., 271 U.S. 445 (1926) 12, 15
Kelly v. Robinson, 479 U.S. 36 (1986) 11, 13
Kham & Nate's Shoes No. 2, Inc. v. First Bank, 908 F.2d 1351 (7th Cir. 1990) 5, 21
M.R.R. Traders, Inc. v. Cave Atlantique, Inc., 788 F.2d 816 (1st Cir. 1986) 22
Marine Harbor Properties, Inc. v. Manufacturer's Trust Co., 317 U.S. 78 (1942) 12, 16
Mason v. Paradise Irrigation District, 326 U.S. 536 (1946) 12
Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. 494 (1986) 10, 13
Nobelman v. American Savings Bank, 508 U.S. 324 (1993) 20
Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) 5
Patterson v. Shumate, 504 U.S. 753 (1992) 8, 21

TABLE OF AUTHORITIES—Continued

Page

Pennsylvania Department of Public Welfare v. Davenport, 495 U.S. 552 (1990) 9
In re Perimeter Park Investment Associates, Ltd., 697 F.2d 945 (11th Cir. 1983) 16
Protective Committee for Independent Stockholders v. Anderson, 390 U.S. 414 (1968) 16
Rake v. Wade, 508 U.S. 464 (1993) 8
In re Robert L. Helms Construction & Development Co., 139 F.3d 702 (9th Cir. 1998) 5
SEC v. American Trailer Rentals Co., 379 U.S. 594 (1965) 16, 19, 20
SEC v. United States Realty & Improvement Co., 310 U.S. 434 (1940) 12, 16
In re Tobiason, 185 B.R. 59 (Bankr. D. Neb. 1995) 6
Toibb v. Radloff, 501 U.S. 157 (1991) 8, 21
Union Bank v. Wolas, 502 U.S. 151 (1991) 8, 15, 19
United Savings Association v. Timbers of Inwood Forest Associates, Ltd., 484 U.S. 365 (1988) 14, 15, 18
United States v. Ron Pair Enterprises, Inc., 489 U.S. 235 (1989) 8, 10, 13, 14
United States v. Whiting Pools, Inc., 462 U.S. 198 (1983) 21

Statutes

11 U.S.C. § 101 11
11 U.S.C. § 363 22
11 U.S.C. § 523(a)(7) 11
11 U.S.C. § 1104(a) 19
11 U.S.C. § 1107(a) 19
11 U.S.C. § 1121 20
11 U.S.C. § 1121(b) 3
11 U.S.C. § 1121(d) 3
11 U.S.C. § 1123(b)(5) 20
11 U.S.C. § 1126(c) 17, 24
11 U.S.C. § 1129(a) 8
11 U.S.C. § 1129(a)(7)(A) 17
11 U.S.C. § 1129(b) ..... *passim*
11 U.S.C. § 1129(b)(1) 4, 8, 17

TABLE OF AUTHORITIES—Continued

	Page
11 U.S.C. § 1129(b)(2)	*passim*
11 U.S.C. § 1129(b)(2)(B)	5, 17
11 U.S.C. § 1129(b)(2)(B)(ii)	5, 6
Act of June 7, 1934, ch. 424, 48 Stat. 911 (superseded 1938)	12
Act of June 22, 1938, ch. 575, 52 Stat. 840 (repealed 1979)	16
Act of July 7, 1952, Pub. L. No. 82-456, 66 Stat. 420 (repealed 1979)	16
Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (codified as amended at 11 U.S.C. § 1 et seq.) (repealed 1979)	9
Bankruptcy Act § 156 (11 U.S.C. § 556) (repealed 1979)	19
Bankruptcy Act §§ 167-170 (11 U.S.C. §§ 567-570) (repealed 1979)	20
Bankruptcy Act §§ 172-175 (11 U.S.C. §§ 572-575) (repealed 1979)	23
Bankruptcy Act § 216 (11 U.S.C. § 616) (repealed 1979)	20
Bankruptcy Act § 221(2) (11 U.S.C. § 621(2)) (repealed 1979)	15
Bankruptcy Act § 306(1) (11 U.S.C. § 706(1)) (repealed 1979)	20
Bankruptcy Act § 323 (11 U.S.C. § 723) (repealed 1979)	20
Bankruptcy Act § 332 (11 U.S.C. § 732) (repealed 1979)	19
Bankruptcy Act § 342 (11 U.S.C. § 742) (repealed 1979)	19
Bankruptcy Act § 357 (11 U.S.C. § 757) (repealed 1979)	20
Bankruptcy Act § 366 (11 U.S.C. § 766) (repealed 1979)	16
Bankruptcy Act § 432 (11 U.S.C. § 832) (repealed 1979)	19
Bankruptcy Act § 444 (11 U.S.C. § 844) (repealed 1979)	19
Bankruptcy Act § 461 (11 U.S.C. § 861) (repealed 1979)	20

TABLE OF AUTHORITIES—Continued

	Page
Bankruptcy Act § 472 (11 U.S.C. § 872 (repealed 1979)	16
Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549	17
Other Authorities	
American Council of Life Insurance, *Life Insurance Fact Book* (1997)	2
John D. Ayer, *Rethinking Absolute Priority After* Ahlers, 87 Mich. L. Rev. 963 (1989)	13
Douglas G. Baird, *The Elements of Bankruptcy* (1992)	17
Collier on Bankruptcy (Lawrence P. King ed., 15th ed. rev. 1997)	13, 18
124 Cong. Rec. (daily ed. Sept. 28, 1978) (statement of Rep. Don Edwards)	18, 19
124 Cong. Rec. (daily ed. Oct. 6, 1978) (statement of Sen. Dennis DeConcini)	18, 19
Julian R. Franks & Walter N. Torous, *An Empirical Investigation of U.S. Firms in Reorganization*, 44 J. Fin. 747 (1989)	23
H.R. Rep. No. 95-595 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963	15, 18, 23
Kenneth N. Klee, *Cram Down II*, 64 Am. Bankr. L.J. 229 (1990)	13
Lynn M. LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. Pa. L. Rev. 125 (1990)	23
Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69 (1991)	13
Walter W. Miller, Jr., *Bankruptcy's New Value Exception: No Longer a Necessity*, 77 B.U. L. Rev. 975 (1997)	17
Elizabeth Warren, *Bankruptcy Policy*, 54 U. Chi. L. Rev. 775 (1987)	21

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BRIEF *AMICUS CURIAE* OF THE AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF PETITIONER

The American Council of Life Insurance ("ACLI") respectfully submits this brief *amicus curiae* in support of petitioner.[1] Petitioner (the "Bank") and respondent (the "Debtor") have consented to the filing of this brief, and their letters of consent have been filed with the Clerk of the Court.

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[1] In accordance with Supreme Court Rule 37.6, ACLI represents that no party other than counsel for ACLI authored this brief in whole or in part, and no person or entity, other than ACLI, has made a monetary contribution to the preparation or submission of this brief.

INTEREST OF *AMICUS CURIAE*

ACLI is the principal national trade association of life insurance companies. The 532 member companies of ACLI account for eighty-nine percent of the legal reserve life insurance in this country and are among the nation's largest and most significant commercial lenders. In 1996, life insurance companies' net investment in U.S. money and capital markets totaled $107 billion, more than ten percent of total institutional funds flowing into the financial markets. American Council of Life Insurance, *Life Insurance Fact Book* 50 (1997). At year-end 1996, life insurers held $951.7 billion in corporate bonds and $207.8 billion in mortgages. *Id.* at 53, 102.

The interest of ACLI as *amicus* arises out of the importance of this case to the commercial lending community. As a principal source of investment capital for both real estate developments and operating businesses, life insurance companies have a broad and important perspective on the proper resolution of the question presented in this case.

SUMMARY OF ARGUMENT

The question presented in this case is "[w]hether the Bankruptcy Code authorizes a judge to confirm a Chapter 11 plan of reorganization that grants the prebankruptcy equity owners of a debtor an exclusive opportunity to retain or purchase an ownership interest in the reorganized debtor, but does not provide for full payment to a senior, objecting class of unsecured creditors." Pet. for Cert. at i. For the sake of brevity and clarity, we refer to the pre-bankruptcy equity owners of the debtor as "old equity" and the exclusive opportunity to retain or purchase the ownership of the debtor as an "equity-only new value right."

The plan of reorganization filed by the Debtor while it had the exclusive right to file a plan [2] and confirmed by the bankruptcy court granted to old equity an equity-only new value right.[3] This right, which is equivalent to an exclusive option to purchase ownership of the reorganized partnership, constitutes property received by old equity on account of old equity's junior interest in the Debtor. Section 1129(b)(2) of the Bankruptcy Code plainly prohibits such a grant of property to old equity in the circumstances of this case.

The Court of Appeals relied on what it believed to be the law and practice before the enactment of the Bankruptcy Code in 1978 and concluded that Congress did not intend to change this practice when it enacted the Bankruptcy Code. The court's reasoning is erroneous in several respects. The clear language of the Bankruptcy Code precludes reliance on pre-Code practice, which, in any event, did not authorize an equity-only new value right. Even if the Court of Appeals had interpreted the historical record correctly, however, the court failed to recognize that Congress intended to alter pre-Code practice, as demonstrated by Congress' substantial reworking of pre-Code reorganization law and its careful treatment of the pre-Code absolute priority rule.

Policy considerations also support reversal of the judgment of the Court of Appeals. An equity-only new value

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[2] During the first 120 days after the commencement of a Chapter 11 case, the debtor has the exclusive opportunity to file a reorganization plan. 11 U.S.C. § 1121(b). The bankruptcy court may increase this exclusive period for cause. *Id.* § 1121(d).

[3] The plan in the case at bar was filed and confirmed during the Debtor's statutory exclusive period under Section 1121(b), as extended by the bankruptcy court. Accordingly, this case does not present the issue addressed by the Ninth Circuit in *In re Bonner Mall Partnership*, 2 F.3d 899, 909 (9th Cir. 1993), *motion to vacate denied and case dismissed*, 513 U.S. 18 (1994), as to the permissibility of an equity-only new value right after the expiration of the debtor's exclusive period.

right does nothing to support the policy of the Bankruptcy Code favoring reorganization, and it is entirely inconsistent with the important policy of maximizing the value of the bankruptcy estate. The Court of Appeals' decision also inserts the bankruptcy judge inappropriately into the plan confirmation process and strips from creditors their power to determine what course of action is in their own best interests.

ARGUMENT

I. THE PLAIN LANGUAGE OF SECTION 1129(b)(2) OF THE BANKRUPTCY CODE PROHIBITS THE GRANT TO OLD EQUITY, OVER THE OBJECTION OF A CLASS OF CREDITORS, OF AN EXCLUSIVE RIGHT TO PURCHASE OWNERSHIP OF THE REORGANIZED DEBTOR.

The plain language of Section 1129(b)(2) of the Bankruptcy Code requires that the question presented in this case be resolved in favor of the Bank. When one or more classes of creditors rejects a proposed plan of reorganization in a Chapter 11 case, the bankruptcy court may confirm the plan only if the plan is, among other things, "fair and equitable" with respect to each objecting class. 11 U.S.C. § 1129(b)(1). Section 1129(b)(2) provides several specific requirements of the fair and equitable standard, including the Bankruptcy Code's absolute priority rule. With respect to a class of unsecured claims such as the Bank's deficiency claim in the instant case, a plan is not fair and equitable unless:

> (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
>
> (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B). As this Court has recognized, "the absolute priority rule 'provides that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan.'" *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988) (quoting Eighth Circuit opinion) (alteration by this Court).

It is undisputed that the Bank will not receive property under the plan of a value equal to the allowed amount of its unsecured deficiency claim. *See* Resp. to Pet. for Cert. at 3 (acknowledging that the Bank is projected to receive payments with a present value equivalent to 16% of its deficiency claim). The bankruptcy court's confirmation of the reorganization plan proposed by the Debtor, therefore, was proper only if holders of interests in the Debtor (*i.e.*, old equity) did not "receive or retain under the plan on account of such junior . . . interest[s] any property." 11 U.S.C. § 1129(b)(2)(B)(ii).

Although the Debtor suggests that old equity did not receive any "property" under the plan, *see* Resp. to Pet. for Cert. at 17-19, this Court has held that ownership of a reorganized debtor, even if it is apparently worthless, constitutes "property," *see Ahlers*, 485 U.S. at 207-08. Similarly, old equity's opportunity to purchase this property to the exclusion of competing offers from other parties also is "property." *See In re Coltex Loop Central Three Partners, L.P.*, 138 F.3d 39, 42-43 (2d Cir. 1998); *In re Bryson Properties, XVIII*, 961 F.2d 496, 504 (4th Cir.), *cert. denied*, 506 U.S. 866 (1992); *Kham & Nate's Shoes No. 2, Inc. v. First Bank*, 908 F.2d 1351, 1360 (7th Cir. 1990).[4] *See generally Ahlers*, 485 U.S. at 208

[4] *Cf. In re Robert L. Helms Constr. & Dev. Co.*, 139 F.3d 702, 706 (9th Cir. 1998) (en banc) (holding that option to purchase real property is not an executory contract; suggesting that it is

(recognizing that Congress intended meaning of "property" to be "quite broad").

The next interpretive question in this case is whether old equity received its property "on account of" its prepetition ownership interest in the Debtor. 11 U.S.C. § 1129(b)(2)(B)(ii). In any case involving an equity-only new value right, the old equity owners are chosen from the universe of possible investors as the only individuals who will receive a chance to invest in the reorganized debtor because they are the old equity owners. In this case, it is clear that this is precisely what happened. As the Debtor's papers and the bankruptcy court's decision demonstrate, the old equityholders received this opportunity specifically because they were faced with significant tax liabilities if a plan could not be confirmed and the Bank foreclosed its mortgage on the property. *See* Resp. to Pet. for Cert. at 1, 17; App. to Pet. for Cert. at 112a-113a. No one other than old equity faced such tax liabilities.

The members of the Court of Appeals panel disagreed about whether old equity received ownership of the reorganized Debtor "on account of" new capital contributions or "on account of" former equity interests. *See* App. to Pet. for Cert. at 21a, 35a. What is at issue in this case, however, is not why old equity obtained ownership of the reorganized Debtor, but why the plan granted old equity an *exclusive* opportunity to contribute new capital in exchange for ownership.[5] Any suggestion that old equity

property of bankruptcy estate); *In re Tobiason*, 185 B.R. 59, 63 (Bankr. D. Neb. 1995) (holding that option to purchase stock of another company is property of debtor's bankruptcy estate).

[5] A red herring frequently colors the arguments of debtors and courts in favor of an equity-only new value right. It is the erroneous conclusion that absent an equity-only new value right, old equity would be barred from owning an interest in the reorganized debtor unless either (1) all classes of creditors accepted the plan or (2) all creditors were to be paid in full. The Ninth Circuit, for example, reasoned that if an equity-only new value right were impermissible, "[w]e would then be left with an absolute prohibition against former equity owners' receiving or retaining property in the reorganized debtor [where senior classes are not paid in full]." *Bonner Mall*, 2 F.3d at 909. The law does not require, and ACLI does not suggest, that old equity may never own or control the reorganized debtor unless all classes of creditors either consent to the plan or are paid in full. The absolute priority rule does prohibit a plan that gives old equity exclusive rights to purchase interests in the reorganized debtor while other parties are precluded from having an opportunity to bid for and purchase interests in the reorganized debtor. A new value right that is limited to old equity only, as the Debtor's was, is a grant of property to old equity on account of old equity's ownership of the debtor and triggers the prohibition of Section 1129(b)(2).

received an *exclusive* opportunity to contribute new capital solely "on account of" its contribution of new capital would, of course, be nonsensical.[6] Instead, both the record and common sense indicate that the Debtor selected the old equityholders to receive this benefit precisely because they were the old equityholders.

[6] In attempting to answer this question—*i.e.*, "on account of" what does old equity receive an exclusive opportunity to purchase ownership of the reorganized debtor?—the Court of Appeals resorted to a bald policy proposition:

> As a practical matter, the opportunity to participate in a reorganization plan, even an exclusive right, is not retained on account of an old equity holder's former ownership interest; the opportunity to give new value and to have the opportunity to receive a return on that capital infusion is given because such participation, even exclusive participation, may enhance the value of the business after reorganization.

App. to Pet. for Cert. at 21a. This proposition is dubious as a matter of policy, for it is not at all clear that the value of a business is enhanced when willing investors are not permitted to offer to purchase ownership. It also is unpersuasive as a matter of statutory interpretation, for it simply fails to explain why the equity-only new value right that the old equityholders received to enable them to defer their tax liabilities was not given to them "on acount of" their equity interests.

The Bankruptcy Code provides no exception to the absolute priority rule in the circumstances of this case.[7] Nor is there any ambiguity about the meaning of the absolute priority rule on the facts presented here.[8] In short, there is no statutory justification for the decision of the Court of Appeals in this case.

Where a "statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989) (quoting *Caminetti v. United States*, 242 U.S. 470, 485 (1917)). "[A]s long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute." *Id.* at 240-41. *See also Rake v. Wade*, 508 U.S. 464, 471-73 (1993) (quoting and following *Ron Pair*); *Patterson v. Shumate*, 504 U.S. 753, 759-61 (1992) (holding that clear statutory language precluded reliance on legislative history); *Barnhill v. Johnson*, 503 U.S. 393, 401 (1992) (noting that reference to statutory history is appropriate only to resolve statutory ambiguity); *Union Bank v. Wolas*, 502 U.S. 151, 156-62 (1991) (holding that plain language of Bankruptcy Code controlled, despite arguments that legislative history, pre-Code practice, and policy considerations supported different result); *Toibb v. Radloff*, 501 U.S. 157, 162 (1991)

[7] The absolute priority rule does not apply if all classes of creditors accept the plan, nor does it apply in a cramdown situation to a class that has accepted a plan. *See* 11 U.S.C. §§ 1129(a), 1129(b)(1). Because the class of unsecured creditors that included the Bank rejected the plan, the absolute priority rule applies here.

[8] The Court of Appeals concluded that Section 1129(b) is ambiguous because courts and scholars have disagreed about its proper interpretation. *See* App. to Pet. for Cert. at 18a-19a. This Court, however, regularly interprets the Bankruptcy Code, among other statutes, according to its plain meaning despite recognizing that other courts and commentators have disagreed. *See, e.g., Toibb v. Radloff*, 501 U.S. 157, 160-62 & n.3 (1991); *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 238 & n.1, 241 (1989).

(holding that where language of Bankruptcy Code is clear, reference to legislative history is unnecessary); *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 563-64 (1990) (holding that pre-Code practice did not override clear language of Bankruptcy Code); *Central Trust Co. v. Official Creditors' Committee*, 454 U.S. 354, 359-60 (1982) (per curiam) (holding that court's belief about best interests of bankruptcy estate cannot override unambiguous statutory language).

Accordingly, because the plain meaning of Section 1129 of the Bankruptcy Code prohibits an equity-only new value right, the Court of Appeals erred in affirming confirmation of the Debtor's plan of reorganization.

II. THE LAW AND PRACTICE PREVAILING BEFORE THE ENACTMENT OF THE BANKRUPTCY CODE IN 1978 DO NOT SUPPORT THE DECISION OF THE COURT OF APPEALS.

The Court of Appeals reasoned that the so-called "new value corollary" had a longstanding heritage under the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (codified as amended at 11 U.S.C. § 1 et seq.) (repealed 1979) (hereinafter the "Bankruptcy Act"). Drawing on this Court's direction that the Bankruptcy Code should not be interpreted to alter practice under the Bankruptcy Act without an indication that Congress intended such a change, the Court of Appeals concluded that the "new value corollary" survived the enactment of the Bankruptcy Code in 1978 and allowed the equity-only new value right in this case. *See* App. to Pet. for Cert. at 21a-23a.

This Court has recognized that Congress did not write on a clean slate when it enacted the Bankruptcy Code in 1978. *See Dewsnup v. Timm*, 502 U.S. 410, 419 (1992). The courts "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Davenport*, 485 U.S. at 563. In general, this Court assumes that "if Con-

gress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Protection*, 474 U.S. 494, 501 (1986). Further, the Court is "reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup*, 502 U.S. at 419.

The Court of Appeals erred in three respects in its application of these principles to the instant case. First, when the language of the Bankruptcy Code is clear, resort to pre-Code practice is inappropriate. Second, the "new value corollary" was not an established element of bankruptcy law before 1978. Third, Congress gave a clear indication that it intended to depart from the pre-Code absolute priority rule when it enacted the Bankruptcy Code in 1978.

A. Pre-Code Law and Practice Are Irrelevant When the Language of the Bankruptcy Code Is Clear.

As discussed above in Part I, there is no ambiguity in Section 1129(b) of the Bankruptcy Code as applied to the facts of this case. Where the language of the Bankruptcy Code is not "at least to some degree . . . open to interpretation," pre-Code practice cannot override the language of the Bankruptcy Code. *Ron Pair*, 489 U.S. at 245; *see also Davenport*, 485 U.S. at 552-53 (applying clear language of Bankruptcy Code despite contrary pre-Code practice). Similarly, an absence of discussion in the legislative history cannot alter the Bankruptcy Code's plain meaning. *See Dewsnup*, 502 U.S. at 419-20 ("Of course, where the language is unambiguous, silence in the legislative history cannot be controlling."). As the Court has recognized in these and the other cases cited in Part I, the plain language of the Bankrupcy Code is the clearest guide to congressional intent, and other considerations do not override Congress's choice of clear statutory wording.

Two of this Court's cases are instructive in this regard. In *Kelly v. Robinson*, 479 U.S. 36 (1986), the Court considered whether a criminal restitution order is dischargeable in a case under Chapter 7 of the Bankruptcy Code. The Court recognized that pre-Code practice included a judicially-created exception to discharge for restitution orders. *See id.* at 45-46. The Court determined that the ambiguous language in the relevant discharge provision, 11 U.S.C. § 523(a)(7), did not reveal an intent to alter the pre-Code rule and concluded that restitution orders remain nondischargeable. *See id.* at 47-53.

Three Terms later, in *Davenport*, the Court again considered the dischargeability of a restitution order, this time in a Chapter 13 case. Because Section 523(a)(7) does not apply in Chapter 13 cases, the Court looked to the definitions of "debt" and "claim" in 11 U.S.C. § 101. Concluding that a criminal restitution obligation is a debt within the meaning of that section of the Bankruptcy Code and recognizing that Chapter 13 provides for a broad discharge of debts, the Court held that a restitution obligation is dischargeable in a Chapter 13 case. *See Davenport*, 495 U.S. at 557-63. The Court acknowledged that the Bankruptcy Code should not be read to alter past practice absent a clear congressional indication but found that "the statutory language plainly reveals Congress' intent not to except restitution orders from discharge in certain Chapter 13 proceedings." *Id.* at 563.

As in *Davenport*, the congressional intent behind the codification of the absolute priority rule is clear in this case. Section 1129(b) defines the contours of the rule without ambiguity and permits no exception for an equity-only new value right. In such a case, the Court's "sole function is to enforce the statute according to its terms." *Id.* at 564.

B. The New Value Doctrine Was Not an Established Element of Pre-Code Law or Practice.

The Court of Appeals concluded that "for more than fifty years, the new value precept has been recognized as an important corollary or exception to the absolute priority rule" and that it "has been a major source of new funding in reorganizations for the past fifty years." App. to Pet. for Cert. at 19a, 21a. A brief review of the history of the new value doctrine demonstrates that the Court of Appeals misread the historical record.

Arguments in favor of a new value doctrine invariably rely on this Court's discussion of the issue in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939). In *Los Angeles Lumber*, a reorganization case under Section 77B of the Bankruptcy Act,[9] the Court drew on dicta from *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926), and suggested that in certain circumstances, stockholders could make a new contribution of capital in exchange for a reasonably equivalent ownership interest in the reorganized debtor. *See Los Angeles Lumber*, 308 U.S. at 117, 121-22. Because the contribution proffered by the stockholders in *Los Angeles Lumber* was insufficient as a matter of law, these discussions were dicta, as this Court has recognized previously. *See Ahlers*, 485 U.S. at 203.

The new value doctrine appeared in several other opinions of this Court in the 1940s, but in each case, the discussion of the doctrine was unnecessary to the resolution of the controversy. *See Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.*, 317 U.S. 78, 85-86 (1942); *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510, 529-30 & n.27 (1941); *SEC v. United States Realty & Improvement Co.*, 310 U.S. 434, 454 (1940); *cf. Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 541-43 (1946) (discussing related issues in case involving investment by creditor in Chapter IX reorganization of public debtor). This Court was not alone, however, in its failure ever to apply the new value doctrine to the facts of a case. In the thirty-nine years from *Los Angeles Lumber* until the enactment of the Bankruptcy Code in 1978, no court concluded in a published decision that the new value doctrine permitted an exception to the absolute priority rule on the facts of a particular case. *See* 7 *Collier on Bankruptcy* ¶ 1129.04[4][c], at 1129-107 (Lawrence P. King ed., 15th ed. rev. 1997); Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 92 (1991); Kenneth N. Klee, *Cram Down II*, 64 Am. Bankr. L.J. 229, 241 (1990); John D. Ayer, *Rethinking Absolute Priority After* Ahlers, 87 Mich. L. Rev. 963, 1016 (1989).

The historical pedigree of the new value doctrine, therefore, is sketchy at best, consisting entirely of theory and dicta. By contrast, in each of the cases in which this Court found that pre-Code law and practice were determinative, the Court concluded that *firmly established* pre-Code principles carried over into the post-1978 statutory scheme. *See Dewsnup*, 502 U.S. at 418 (describing pre-Code law on lien-stripping as "clearly established"); *Kelly*, 479 U.S. at 46 (recognizing "widely accepted" and "established" law on dischargeability of restitution orders); *Midlantic Nat'l Bank*, 474 U.S. at 501 (describing "well-recognized restrictions on a trustee's abandonment power").

The new value doctrine was not an established pre-Code practice; rather, it is similar to the purported pre-Code practice dismissed by this Court in *Ron Pair* as "an exception to an exception, recognized by only a few courts and often dependent on particular circumstances." *Ron Pair*, 489 U.S. at 246. Of the supposed rule proffered by the debtor in that case, the Court said: "It was certainly not the type of 'rule' that we assume Congress was aware of when enacting the Code; nor was it of such significance that Congress would have taken steps other than

[9] Section 77B was enacted by the Act of June 7, 1934, ch. 424, sec. 1, 48 Stat. 911, 912 (superseded 1938).

enacting statutory language to the contrary." *Id.*; *see also United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 381-82 (1988) ("The at best divided authority under Chapter XI [of the Bankruptcy Act] removes all cause for wonder that the alleged departure from it should not have been commented upon in the legislative history.") As discussed in the next subsection, Congress dealt with the new value doctrine precisely as it dealt with the rules at issue in *Ron Pair* and *Timbers of Inwood Forest*: it enacted statutory language to the contrary.

C. Congress Indicated Clearly That It Intended to Eliminate the New Value Doctrine When It Modified and Codified the Absolute Priority Rule, Without Exception, as Part of a Complete Overhaul of the Reorganization Provisions of the Bankruptcy Act.

Congress completely reworked the law of business reorganization when it enacted the Bankruptcy Code in 1978. *See Ron Pair*, 489 U.S. at 240 (stating that Congress "made significant changes in both the substantive and procedural laws of bankruptcy" and conducted "a substantial overhaul of the system"). As one part of this overhaul, Congress drew from the case law the rule of absolute priority, incorporated that rule into the new Bankruptcy Code in modified form, and made no mention of any exception to the rule for contributions by old equity. To the extent that the new value doctrine played any role in practice under the Bankruptcy Act,[10] Congress' handling of the absolute priority rule is a clear indication that Congress intended to abrogate the doctrine. *See Davenport*, 495 U.S. at 563-64 (holding that broad definition of "debt" and decision to limit exceptions to discharge in Chapter 13 revealed congressional

[10] For the remainder of this subsection, we assume for the sake of argument that the new value doctrine was an established element of practice under Chapter X of the Bankruptcy Act.

intent to allow discharge of restitution obligation); *Union Bank*, 502 U.S. at 160 (holding that substantial changes to pre-Code law favored conclusion that text of Bankruptcy Code reflected congressional intent).

The legal landscape of business reorganization under the Bankruptcy Act was strikingly different than it is today. Businesses seeking to reorganize could proceed under one of three chapters of the Bankruptcy Act, each of which had distinct rules and requirements. Describing the situation in 1977, the House Committee on the Judiciary reported that "chapter X . . . provides a complete financial restructuring of a corporation; chapter XI provides for arrangements and compositions for corporations, partnerships, and individuals; and chapter XII contains the procedures for arrangements for noncorporate entities involved in real estate." H.R. Rep. No. 95-595, at 221 (1977) (footnotes omitted), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6181. In the Bankruptcy Code, Congress selected elements from each of these chapters, added several new provisions, and created a single reorganization chapter, Chapter 11. *See generally Timbers of Inwood Forest*, 484 U.S. at 380-81 (discussing replacement of three reorganization chapters with Chapter 11).

In a reorganization under Chapter X of the Bankruptcy Act, a judge could not confirm a plan unless, among other things, it was "fair and equitable." Bankruptcy Act § 221(2) (11 U.S.C. § 621(2)) (repealed 1979). This Court read that language to require absolute priority, and not merely relative priority, among classes of creditors and interestholders, so that " 'to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation.' " *Los Angeles Lumber*, 308 U.S. at 116-17 (quoting *Kansas City Terminal Ry.*, 271 U.S. at 455).[11] In addition,

[11] As noted above, *Los Angeles Lumber* was decided under Section 77B of the Bankruptcy Act. However, the "fair and equitable" requirement applied in the same fashion under Chapter X. *See*

the "fair and equitable" requirement applied even if the overwhelming majority of creditors approved a reorganization plan that did not comply with absolute priority; a single dissatisfied creditor could upset an otherwise consensual reorganization. *See id.* at 114-15 (reversing confirmation based on objection by holder of less than one percent of bonds, despite approval of more than ninety percent of bondholders and stockholders).

When Chapters XI and XII were enacted, they too contained a "fair and equitable" requirement. Act of June 22, 1938, ch. 575, sec. 1, 52 Stat. 840, 911-12, 923 (adding Bankruptcy Act §§ 366, 472 (11 U.S.C. §§ 766, 872)) (repealed 1979); *United States Realty*, 310 U.S. at 452 (recognizing that Chapter XI incorporated "fair and equitable" test). In 1952, however, Congress deleted this requirement from Chapters XI and XII. *See SEC v. American Trailer Rentals Co.*, 379 U.S. 594, 610-11 (1965) (recognizing deletion of absolute priority rule from Chapter XI); *In re Perimeter Park Inv. Assocs., Ltd.*, 697 F.2d 945, 952 (11th Cir. 1983) (recognizing deletion of absolute priority rule from Chapter XII). At the same time, Congress added language to Chapters XI and XII stating specifically that confirmation should not be denied solely because old equity would retain its interest. Act of July 7, 1952, Pub. L. No. 82-456, secs. 35, 43, 66 Stat. 420, 433, 435 (amending Bankruptcy Act §§ 366, 472 (11 U.S.C. §§ 766, 872)) (repealed 1979). Congress surely was aware of this language, like the *Los Angeles Lumber* dicta, when it created Chapter 11 of the Bankruptcy Code, and one might expect that if Congress intended to import the new value doctrine into the Bankruptcy Code, it would have found this language helpful. Yet nothing remotely similar to this language appears anywhere in the Bankruptcy Code.[12]

Protective Comm. for Indep. Stockholders v. Anderson, 390 U.S. 414, 441 (1968); *Marine Harbor Properties*, 317 U.S. at 85-87.

[12] Similarly, Congress rejected the suggestion of the Commission on the Bankruptcy Laws of the United States that the new value doctrine be broadened to include non-monetary contributions by old equity. *See Ahlers*, 485 U.S. at 205-06.

In 1978, Congress was faced with the task of combining three reorganization chapters of the Bankruptcy Act, with differing approaches to the issue of absolute priority, into a single Chapter 11 of the new Bankruptcy Code. Chapter X contained a strict absolute priority rule that could not be waived by a class of affected creditors, along with an exception when old equity contributed new value. Chapters XI and XII contained no absolute priority rule at all, so that new value never became an issue. Congress responded by drawing the absolute priority rule from case law interpreting Chapter X, enacting the rule in statutory form for the first time, and applying it to all business reorganization cases, although in a modified fashion.

The Bankruptcy Code, the result of Congress' modification of pre-Code law, defines the "fair and equitable" requirement to include the absolute priority rule. 11 U.S.C. § 1129(b)(2)(B). The rule applies only to classes of creditors that do not accept the plan. 11 U.S.C. § 1129(b)(1). A class is deemed to accept the plan if creditors holding two-thirds in amount and one-half in number of claims vote to accept. 11 U.S.C. § 1126(c). Dissenting members of an accepting class are not entitled to object on the basis of absolute priority; they are protected only by the best-interests-of-creditors test, which ensures that they receive at least as much as they would receive in a Chapter 7 liquidation. 11 U.S.C. § 1129(a)(7)(A). Thus, as commentators have recognized, if *Los Angeles Lumber* had been decided under the Bankruptcy Code, the absolute priority rule would not have been an issue, and this Court would not have overturned the confirmation of the plan. *See, e.g.*, Walter W. Miller, Jr., *Bankruptcy's New Value Exception: No Longer a Necessity*, 77 B.U. L. Rev. 975, 1010-11 (1997); Douglas G. Baird, *The Elements of Bankruptcy* 249 (1992).

The legislative history of the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, evidences Congress' intent to rework the absolute priority principles of pre-Code law.[13] The House Report accompanying the bill that became the Bankruptcy Reform Act expressed dissatisfaction with the application of the absolute priority rule under Chapter X and concern about the lack of such a rule under Chapter XI. *See* H.R. Rep. No. 95-595, at 222-23 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6181-82. The Report then described the bill's version of the rule as "a *partial* application of the absolute priority rule now applied under Chapter X" and a "*partial* codification of the absolute priority rule." *Id.* at 224, 414 (emphasis added), 1978 U.S.C.C.A.N. at 6184, 6370. The floor leaders of the bill cautioned before final passage that "chapter 11 of the House amendment does not represent an extension of chapter X of current law or any other chapter of the Bankruptcy Act." 124 Cong. Rec. H11,100 (daily ed. Sept. 28, 1978) (statement of Rep. Don Edwards); 124 Cong. Rec. S17,417 (daily ed. Oct. 6, 1978) (statement of Sen. Dennis DeConcini).[14] They also explained the workings of the modified absolute priority rule, emphasizing that "the fair and equitable requirement applies only with respect to dissenting classes . . . unlike the fair and equitable rule contained in Chapter X" and explaining that "the plan may be confirmed if the impaired class of unsecured claims receives less than 100 cents on the dollar (or nothing at all) so long as no class junior to the dissenting class receives anything at all." 124 Cong. Rec. H11,104, 11,105 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards); 124 Cong. Rec. S17,420, 17,421 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini).

[13] Because of the significant differences among the reorganization chapters of the Bankruptcy Act, silence in the legislative history is not a helpful guide in determining congressional intent. *Cf. Timbers of Inwood Forest*, 484 U.S. at 381 ("[A]s far as the silence of the legislative history on the point is concerned, that would be no more strange with respect to alteration of the asserted Chapter XI rule than it would be with respect to alteration of the Chapters X and XII rule."). Nevertheless, because the legislative history reveals that Congress meant what it wrote in Section 1129(b) of the Bankruptcy Code, we discuss it here.

[14] These floor statements are reprinted in 1978 U.S.C.C.A.N., beginning at pages 6436 and 6505, and in part 4(f) of the appendix to *Collier on Bankruptcy* (15th ed. rev. 1997).

Congress carefully examined and significantly altered the absolute priority rule that prevailed in cases under Chapter X of the Bankruptcy Act. In light of Congress' devotion of substantial time and attention to the absolute priority rule, the logical conclusion is that Congress meant for the rule to be applied as it was enacted, without exception. *See Union Bank*, 502 U.S. at 160 ("[T]he fact that Congress carefully reexamined and entirely rewrote the preference provision in 1978 supports the conclusion that the text of § 547(c)(2) reflects the deliberate choice of Congress.").

In combining the three reorganization chapters of the Bankruptcy Act into a single chapter of the Bankruptcy Code, Congress faced other situations in which it had to decide among different rules prevailing under the various chapters of the Bankruptcy Act. For example:

- Chapter X of the Bankruptcy Act required the appointment of a disinterested trustee to manage any debtor with liabilities of $250,000 or more. Bankruptcy Act § 156 (11 U.S.C. § 556) (repealed 1979); *American Trailer Rentals*, 379 U.S. at 604. In contrast, the debtor normally remained in possession of its assets under Chapters XI and XII. Bankruptcy Act §§ 332, 342, 432, 444 (11 U.S.C. §§ 732, 742, 832, 844) (repealed 1979); *American Trailer Rentals*, 379 U.S. at 606. In the Bankruptcy Code, Congress drew on Chapters XI and XII and created a preference for debtor control except in extraordinary situations. *See* 11 U.S.C. §§ 1104(a), 1107(a).

- Any party in interest could propose a reorganization plan under Chapter X of the Bankruptcy Act. Bankruptcy Act §§ 167-170 (11 U.S.C. §§ 567-570) (repealed 1979); *American Trailer Rentals*, 379 U.S. at 604. Only the debtor could propose an arrangement under Chapter XI. Bankruptcy Act §§ 306(1), 323 (11 U.S.C. §§ 706(1), 723) (repealed 1979); *American Trailer Rentals*, 379 U.S. at 606. Congress created a hybrid rule in the Bankruptcy Code, giving the debtor-in-possession the exclusive right to propose a plan for the first 120 days after the entry of an order for relief and allowing the court to extend that exclusive period. 11 U.S.C. § 1121.

- A plan under Chapter X or Chapter XII could modify the rights of all creditors. Bankruptcy Act §§ 216, 461 (11 U.S.C. §§ 616, 861) (repealed 1979); *American Trailer Rentals*, 379 U.S. at 604. Chapter XI, by contrast, was limited to the adjustment of unsecured debts. Bankruptcy Act §§ 306(1), 357 (11 U.S.C. §§ 706(1), 757) (repealed 1979); *American Trailer Rentals*, 379 U.S. at 605. As enacted, Chapter 11 of the Bankruptcy Code followed Chapters X and XII of the Bankruptcy Act in allowing the debtor to modify the rights of all creditors. Bankruptcy Reform Act sec. 101, § 1123.[15]

Taken together with Congress' specific decisions about the absolute priority rule, these more general choices about the structure of the new reorganization chapter of the Bankruptcy Code demonstrate that Congress carefully thought through its decisions and enacted the absolute priority rule in the form it desired—without exception for new value contributed by old equity.

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[15] A 1994 amendment to the Bankruptcy Code limited the debtor's ability to modify the rights of a mortgagee of the debtor's principal residence. *See* 11 U.S.C. § 1123(b)(5). *See generally Nobelman v. American Sav. Bank*, 508 U.S. 324 (1993) (interpreting identical language in Chapter 13).

III. AN EQUITY-ONLY NEW VALUE RIGHT IS INCONSISTENT WITH THE POLICIES UNDERLYING THE BANKRUPTCY CODE.

The decision of the Court of Appeals, allowing an equity-only new value right, ill-serves fundamental policies behind the Bankruptcy Code and is inconsistent with a number of other congressional policy decisions. "[T]o the extent that policy considerations are even relevant where the language of the statute is so clear," *Patterson*, 504 U.S. at 764, the Bank's reading of Section 1129(b) is preferable to the Court of Appeals'.

Two of the broadest goals of the reorganization provisions of the Bankruptcy Code are (1) to permit businesses to reorganize and remain viable, thereby preserving jobs and protecting investors, and (2) to maximize the value of the bankruptcy estate. *See Toibb*, 501 U.S. at 163; *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203-04 (1983); Elizabeth Warren, *Bankruptcy Policy*, 54 U. Chi. L. Rev. 775, 787-89 (1987). An equity-only new value right does nothing to promote the first of these goals, for a business can be reorganized regardless of who owns it. If, as may be the case with certain businesses, old equity's ownership or management provides value to the business, creditors can agree to allow old equity to continue as owners, managers, or both. *See Kham & Nate's Shoes*, 908 F.2d at 1360. But permitting old equity to retain ownership over the objection of creditors does not promote the Bankruptcy Code's pro-reorganization policy. In the instant case, successful reorganization is an impossible goal in any event. The bankruptcy court found that even after ten years of operation, the reorganized Debtor would remain insolvent. *See* App. to Pet. for Cert. at 139a.

An equity-only new value right is flatly inconsistent with the policy of maximizing the bankruptcy estate. A plan of reorganization that prohibits any party other than old

equity from offering to purchase ownership of the reorganized business is, in effect, an auction to which only one bidder is invited. No bankruptcy judge would think it appropriate to conduct a one-party auction of property of the bankruptcy estate under 11 U.S.C. § 363. *See, e.g., M.R.R. Traders, Inc. v. Cave Atlantique, Inc.*, 788 F.2d 816, 818 (1st Cir. 1986) (concluding that bankruptcy court properly reopened auction after discovering that interested bidder did not receive notice of sale); *In re Abbotts Dairies of Penn., Inc.*, 788 F.2d 143, 149 (3d Cir. 1986) (remanding for determination whether purchaser of assets acted in good faith or colluded with debtor to freeze out potential bidders); *cf. In re Food Barn Stores, Inc.*, 107 F.3d 558, 562-63 (8th Cir. 1997) (holding that bankruptcy court should not "prequalify" bidders when soliciting assignees for debtor's unexpired lease under 11 U.S.C. § 365). An exclusive opportunity to purchase ownership interests in the reorganized debtor is no less inappropriate. No amount of scrutiny by the bankruptcy judge to determine whether old equity's proposed contribution is "substantial" or "reasonably equivalent" to the equity retained can resolve the fundamental difficulty that parties other than old equity may be willing to pay more for ownership than old equity offers.[16]

Another policy concern driving the enactment of the Bankruptcy Code was the perception that bankruptcy judges were too involved in the administration of cases under the Bankruptcy Act. The House Committee on the Judiciary explained:

[16] The Court of Appeals suggested that an equity-only new value right could enhance the value of a debtor's business, arguing that "exclusivity may be necessary simply because it may be easier to obtain additional funding from the old equity participants." App. to Pet. for Cert. at 21a. Certainly in many Chapter 11 cases, it will be most convenient for the debtor to obtain funding from old equity. Convenience does not equal necessity, however, nor does it justify barring others from attempts to provide funding in amounts greater than what old equity is willing to provide.

> When the Bankruptcy Act was adopted 80 years ago, the underlying premise was that the money of the estate was essentially a trust for the benefit of the bankrupt's creditors. Consequently, the creditors themselves should be entitled to supervise the collection and liquidation of the estate.

H.R. Rep. No. 95-595, at 91 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6053. Instead, the process was effectively controlled by the court, leading the Committee to state that "[c]reditor control in bankruptcy cases is a myth." *Id.* at 92, 1978 U.S.C.C.A.N. at 6053. Congress responded to this problem by, among other things, creating the United States Trustee system and altering the method of selecting members of creditors' committees. *See id.* at 100-05, 1978 U.S.C.C.A.N. at 6061-66. The Bankruptcy Code also gives creditors, and not bankruptcy judges or the Securities and Exchange Commission, the responsibility to determine what is in their best interests, especially in the area of plan confirmation. *Cf.* Bankruptcy Act §§ 172-175 (11 U.S.C. §§ 572-575) (repealed 1979) (requiring approval of plan by judge and, in larger cases, report by SEC before plan could be submitted to creditors and stockholders). A judge no longer may override the decision of a majority of a class of creditors to accept a plan that does not comply with the absolute priority rule, as this Court did in *Los Angeles Lumber*. Instead, "the Code provides that it is up to the creditors—and not the courts—to accept or reject a reorganization plan which . . . fails to honor the absolute priority rule." *Ahlers*, 485 U.S. at 207.[17]

[17] Empirical evidence suggests that creditors frequently accept plans that would not satisfy the absolute priority rule. *See* Lynn M. LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. Pa. L. Rev. 125 (1990); Julian R. Franks & Walter N. Torous, *An Empirical Investigation of U.S. Firms in Reorganization*, 44 J. Fin. 747 (1989).

The equity-only new value right endorsed by the Court of Appeals turns this principle on its head. An equity-only new value right requires the bankruptcy judge to determine whether old equity's proffered contribution is "substantial," "reasonably equivalent" to the value of the reorganized debtor, and "necessary"—all without ever considering whether a creditor or some other person would be willing to pay the bankruptcy estate more to purchase ownership. The Court of Appeals' decision, therefore, both reinserts the bankruptcy judge into the confirmation process and excludes creditors from participating in deciding the fate of the debtor.

This Court concluded its discussion of equitable and policy considerations in *Ahlers* as follows:

> The Court of Appeals may well have believed that petitioners or other unsecured creditors would be better off if respondents' reorganization plan was confirmed. But that determination is for the creditors to make in the manner specified by the Code. 11 U.S.C. § 1126(c). Here, the principal creditors entitled to vote in the class of unsecured creditors (*i.e.*, petitioners) objected to the proposed reorganization. This was their prerogative under the Code, and courts applying the Code must effectuate their decision.

Ahlers, 485 U.S. at 207. The Court's concerns in *Ahlers* are equally valid in the case at bar. Policy considerations support the plain language of Section 1129(b) of the Bankruptcy Code, which prohibits an equity-only new value right and requires reversal of the judgment of the Court of Appeals.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be reversed and the case should be remanded for further proceedings in the bankruptcy court.

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